AUDIT TIPS FOR MANAGING DISASTER-RELATED PROJECT COSTS

Department of Homeland Security
Office of Inspector General
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I. Introduction

The Department of Homeland Security (DHS), Office of Inspector General (OIG), prepared this guide for recipients of Federal Emergency Management Agency (FEMA) public assistance and hazard mitigation funds. Using it will help you to:

- Document and account for disaster-related costs,
- Minimize the loss of FEMA disaster assistance program funds,
- Maximize financial recovery, and
- Prevent fraud, waste, and abuse of disaster funds.

II. Overview of the Office of Inspector General

The Homeland Security Act of 2002 established the OIG in DHS by amendment to the Inspector General Act of 1978 (P.L. 95-452). The OIG serves as an independent office to promote economy, efficiency, and effectiveness; to prevent waste, fraud, and abuse; and to keep Congress and the Secretary of DHS fully informed of problems in DHS programs and operations. The principal functions of the OIG are to:

- Perform or oversee audit and investigative functions relating to programs and operations of DHS,
- Inspect department activities to identify actual or potential fraud, waste, abuse, or mismanagement, and to develop recommendations for corrective action, and
- Investigate allegations of illegal, unethical, or other activities that may lead to civil or criminal liability on the part of DHS or its employees, contractors, or program participants.

III. Applicable Federal Regulations and FEMA Guidelines

Many directives are available to you as a public assistance or hazard mitigation applicant. Some help in responding to and recovering from a disaster and others help in getting and managing Federal funds. The most important is Title 44 of the Code of Federal Regulations (44 CFR), which contains policies and procedures for implementing the Robert T. Stafford Disaster Relief and Emergency Assistance Act, as amended (Stafford Act). These basic policies and procedures govern disaster relief operations. Title 44 CFR is available at the following website: http://www.gpo.gov/fdsys/browse/collectionCfr.action?collectionCode=CFR.

Pay particular attention to 44 CFR part 13 that sets forth administrative requirements for Federal grants and sub-grants to State, local, and Indian tribal governments (2 CFR Part 215 sets forth administrative requirements for non-profits (schools, electric co-ops, hospitals, etc.)). Also, pay particular attention to 44 CFR Part 206 that sets forth the disaster assistance rules applicable to major disasters and emergencies declared by the President.

In addition to 44 CFR, FEMA has several program specific policy documents that will assist you in understanding all aspects of the Public Assistance and Hazard Mitigation Grant Programs. The websites below will give you access to a number of FEMA resources including the following:

- FEMA 321, *Public Assistance Policy Digest* (January 2008)
- FEMA 322, *Public Assistance Guide* (June 2007)
- FEMA 323, *Public Assistance Applicant Handbook* (March 2010)
- FEMA 325, *Public Assistance Debris Management Guide* (July 2007)
- FEMA 327, *Debris Monitoring Guide* (October 2010)
- FEMA 329, *Debris Estimating Field Guide* (September 2010)
- FEMA Disaster Assistance Policy (9500 series policy statements)
- Hazard Mitigation Assistance (HMA) Unified Guidance

http://www.fema.gov/government/grant/pa/policy.shtm
http://www.fema.gov/government/grant/hma/grant_resources.shtm.

Additionally there are relevant Office of Management and Budget (OMB) circulars that apply to eligible applicants as summarized below:

States, local, and Indian Tribal governments

- A-87 for cost principles (revised 05/10/2004), Relocated to 2 CFR, part 225,
- A-102 for administrative requirements, and
- A-133 for audit requirements.

Educational Institutions (even if part of a State or local government)

- A-21 for cost principles (revised 05/10/2004), Relocated to 2 CFR, part 220,
- A-110 for administrative requirements, and
- A-133 for audit requirements.

Non-Profit Organizations

- A-122 for cost principles (revised 05/10/2004), Relocated to 2 CFR, part 230,
- A-110 for administrative requirements, and
- A-133 for audit requirements.

Links to these OMB circulars are located at www.whitehouse.gov/omb/circulars/index.html.

IV. The Audit Process and Frequent Audit Findings

The OIG reviews several factors to determine which activities to audit. These factors include:

- Statutory and regulatory requirements;
- Current or potential dollar magnitude;
- Requests from congressional, FEMA, or State officials; and
- Reports/allegations of impropriety or problems in implementing the FEMA programs.

The OIG tries to review the full range of FEMA-funded disaster activities (temporary housing, public assistance, mitigation, etc.) and organizations that receive funds for conducting those activities.

Generally, the OIG schedules audits no later than three years after the grantee or subgrantee reports that all work has been completed and the final expenditure report has been submitted. However, audits may be done after a majority of the work has been completed and before a grant or subgrant recipient submits its final expenditure report. The audits are conducted mainly to determine whether the grantee and subgrantees expended and accounted for FEMA funds according to Federal regulations and FEMA guidelines.

Frequent Audit Findings (examples)

A. <u>Poor Contracting Practices</u>

Criteria: According to Federal regulations (44 CFR 13.36), non-State grantees and subgrantees must comply with the following procurement standards:[1]

- Grantees and subgrantees will maintain a contract administration system which ensures that contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders;

- The subgrantee must maintain records in sufficient detail to reflect the significant history of the procurement, including the rationale for the method of procurement, the basis for the contractor selection, and the basis for the contract price;

- The subgrantee will only use time-and-material-type (T&M) contracts if a determination is made that no other contract is suitable, and provided that the contract includes a ceiling price that the contractor exceeds at its own risk;

- The subgrantee must conduct all procurement transactions in a manner providing full and open competition. Noncompetitive procurement may be used under certain circumstances, one of which is when the public exigency or emergency will not permit a delay resulting from competitive solicitation;

- The subgrantee must take all necessary affirmative steps to assure that minority firms, women's business enterprises, and labor surplus area firms are used, when possible, during the procurement process;

- The subgrantee must require profit to be negotiated as a separate element of the price for each contract in which there is no price competition and in all cases where cost analysis is performed; and

- The subgrantee is prohibited from using a cost-plus-percentage-of-cost contract arrangement.

[1] States must follow the same policies and procedures they use for procurements using non-federal funds.

Finding 1: Subgrantee officials did not comply with Federal procurement regulations and FEMA guidelines when they awarded 4 of 5 debris contracts totaling $44.6 million. Because the subgrantee awarded these contracts non-competitively, FEMA had no assurance that the subgrantee paid reasonable rates. Additionally, the subgrantee did not adequately monitor its contracts. Contract monitoring includes comparing staff and equipment hours invoiced to actual observations of work performed. The audit identified instances where the subgrantee paid contractor invoices submitted in which staff and equipment time did not agree with the contractor's time and attendance, and equipment usage records. Because the subgrantee did not effectively monitor the contract, FEMA had no assurance that the hours charged on invoices were for actual time worked. Therefore, the OIG questioned $44.6 million due to improper contracting, and for ineligible or unsupported costs.

Finding 2: The subgrantee inappropriately used a T&M contract, because the scope of work was known, included unauthorized markups, and did not include a cost ceiling. By definition, T&M contracts provide for acquiring supplies or services on the basis of (1) direct labor hours at specified fixed hourly rates that include wages, overhead, general and administrative expenses, and profit and (2) materials at cost, including, if appropriate, material handling costs. Thus, the T&M rates of these two contractors were to be inclusive of profit and overhead, yet these contractors charged markups of 15 percent to 33 percent on top of their time-and-material rates. Additionally, the subgrantee did not perform any cost or price analysis for these contracts and did not negotiate cost ceilings or "not-to-exceed' contract provisions with its contractors. Thus these contractors had no incentive to contain project costs. Therefore, the OIG questioned $1,243,850 in T&M contract costs because the subgrantee did not perform a cost or price analysis for these contracts and did not negotiate "not-to-exceed' contract provisions with its contractors; and because the contract allowed markups that were tantamount to using a prohibited cost-plus-percentage-of-cost contracting method.

Finding 3: The subgrantee did not openly compete a contract totaling $4.1 million for the replacement/repair of pump stations and electrical components. Instead, the subgrantee used a contractor with which it had an existing business relationship, before the disaster, to complete the work authorized under the FEMA projects. In addition, the subgrantee accepted the contractor's proposed prices without performing an independent analysis of the prices to ensure reasonableness. Finally, the subgrantee did not take steps to identify and use small businesses, minority owned firms, women's business enterprises, and labor surplus area firms. Because the subgrantee did not follow Federal procurement requirements, FEMA has no assurance that the contract costs were reasonable. Therefore, the OIG questioned $4.1 million awarded for the contracted work.

B. <u>Unsupported Costs</u>

Criteria: Federal cost principles (2 CFR 220, 225, and 230) require that costs claimed under Federal programs be adequately supported by source documentation.

Finding 1: The subgrantee claimed $150,000 for contract labor but had invoices and canceled checks to support only $100,000. The OIG questioned the unsupported difference of $50,000.

Finding 2: The subgrantee's claim included $300,000 for force account labor. However, the subgrantee had time sheets and payroll registers to support only $275,000. The OIG questioned the unsupported difference of $25,000.

Finding 3: The subgrantee claimed $1 million for materials withdrawn from its existing inventory to repair its electrical distribution system. The subgrantee had a listing of material items reportedly used for repairs and a listing of the value of such items. However, records reflecting the withdrawal of items from the inventory did not support the listing. Therefore, the OIG allowed the material costs associated with the actual repairs but questioned the $1 million the subgrantee claimed to have taken from its existing inventory.

C. Poor Project Accounting

Criteria: Federal regulations (44 CFR 13.20 and 206.205) require grantees and subgrantees to maintain a system that accounts for FEMA funds on a project-by-project basis. The system must disclose the financial results for all FEMA-funded activities accurately, currently, and completely. It must identify funds received and disbursed, and reference source documentation (i.e., canceled checks, invoices, payroll, time and attendance records, contracts, etc.).

Finding 1: The subgrantee did not account separately for the costs of each project. The subgrantee had five distinct FEMA-funded projects but accounted for project expenditures under one cost center. As a result, the OIG could not verify the subgrantee's claim by project.

Finding 2: The subgrantee's journal of project expenditures did not contain references to payroll or daily activity reports that supported the payroll expenditures charged to the FEMA project. Therefore, the OIG could not systematically trace expenditures for labor to supporting documents nor verify the claimed costs.

D. Duplication of Benefits

Criteria: Section 312 of the Stafford Act prohibits duplication of benefits. In other words, a subgrantee cannot receive disaster funding for activities covered by insurance benefits, other Federal programs, or any other source.

Finding 1: The subgrantee claimed and received $200,000 to repair a fence, replace dirt, and construct a retaining wall at a baseball park facility. However, the subgrantee had insurance coverage that it had not disclosed to FEMA, and received $220,000 from its insurance carrier for the same damages. Therefore, the OIG questioned the $200,000 of FEMA funding received for damages covered by insurance.

Finding 2: The subgrantee claimed and received $100,000 of FEMA funds for road repairs and the replacement of a chain link fence at a Head Start facility. However, the subgrantee also received funds from the U.S. Department of Housing and Urban Development and the U.S. Department of Health and Human Services to carry out the same activities. Therefore, the OIG questioned the $100,000 of FEMA funds received for activities covered by other Federal programs.

E. Excessive Equipment Charges (applicability may vary with hazard mitigation projects)

Criteria: Federal regulations (44 CFR 206.228) require that subgrantees use the FEMA schedule of equipment rates or their local rates, whichever are lower. Applicants that do not have local established rates must use the FEMA equipment rates when claiming costs under a FEMA project.

Finding: The subgrantee claimed $78,348 for the use of bucket trucks based on the FEMA rate of $24 per hour (3,264.5 hours x $24 per hour). However, the subgrantee's local equipment rate for bucket trucks was $16 per hour, or $8 less than the FEMA rate. Therefore, the OIG questioned $26,116 (3,264.5 hours x $8) of excess charges.

F. Excessive Labor and Fringe Benefit Charges

Criteria: According to Federal cost principles (2 CFR 220, 225, and 230), allowable costs must be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit. Additionally, according to 44 CFR 206.228, straight or regular-time salaries and benefits of permanent employees engaged in emergency work (emergency protective measures and debris removal) are not eligible for FEMA Public Assistance funding.

Finding 1: The subgrantee claimed $50,000 claim for overtime fringe benefits based on a fringe benefit rate of 23.55 percent. However, the rate included the cost of worker's compensation, which is not applicable to overtime. The subgrantee should have based its claim on a rate of 10 percent, which would have resulted in charges of $21,231. Therefore, the OIG questioned $28,769 received by the subgrantee for which it was not entitled.

Finding 2: The subgrantee claimed $10,000 for fringe benefits for personnel supplied by a temporary personnel agency. However, the subgrantee did not provide fringe benefits to the workers or pay the personnel agency for the costs claimed. Therefore, the OIG questioned the inappropriate charges of $10,000.

Finding 3: The subgrantee charged a debris-removal project $250,000 for regular time ($150,000) and overtime ($100,000) labor costs of permanent employees. Because regular-time salaries and benefits of a subgrantee's permanent employees engaged in debris removal work are not eligible for FEMA assistance, the OIG questioned the $150,000 claimed for regular-time labor.

G. Unrelated Project Charges

Criteria: According to Federal cost principles (2 CFR 220, 225, and 230), charges to Federal grants must be necessary and reasonable to fulfill the objective of the grant program.

Finding 1: The subgrantee's claim for repairs to its local electrical distribution system included charges of $10,000 for meals provided to the subgrantee's vice presidents, car washes, and a VCR. The OIG questioned these costs because they were for activities that did not benefit the project.

Finding 2: The subgrantee claimed and received $500,000 under a FEMA project to repair Road XYZ. However, the subgrantee's claim included $250,000 for heavy equipment and material charges for Road ABC. The OIG questioned the $250,000 for Road ABC because the road was not included under the project's approved scope of work.

H. Unapplied Credits

Criteria: According to Federal cost principles (2 CFR 220, 225, and 230), grants must be reduced by credits that offset or reduce expenses allocable to Federal awards.

Finding 1: FEMA awarded funds to repair the subgrantee's electrical distribution system. The subgrantee received $15,000 in proceeds from the sale of scrap material related to the FEMA project. However, the subgrantee did not credit the FEMA project with the sale proceeds. Therefore, the OIG questioned $15,000 of the subgrantee's final claim.

Finding 2: The subgrantee received credit discounts totaling $7,000 under a FEMA project for early payments to a contractor. However, the subgrantee did not credit the FEMA project for the discounts. Therefore, the OIG questioned $7,000 of costs under the project.

V. Key Points to Remember When Administering FEMA Grants

1. Designate a person to coordinate the accumulation of records.

2. Establish a separate and distinct account for recording revenue and expenditures, and a separate account for each distinct FEMA project.

3. Ensure that the final claim made for each project is supported by amounts recorded in the accounting system.

4. Ensure that each expenditure is recorded in the accounting books and is referenced to supporting source documentation (checks, invoices, etc.) that can be readily retrieved.

5. Research insurance coverage and seek reimbursement for the maximum amount. Credit the appropriate FEMA project with that amount.

6. Check with your Federal Grant Program Coordinator about the availability of funding under other Federal programs (i.e., Federal Highway, Housing and Urban Development, etc.) and ensure that the final project claim does not include costs that were funded or should be funded by another Federal agency.

7. Ensure that materials taken from existing inventories for use under FEMA projects are documented by inventory withdrawal and usage records.

8. Do not charge the regular time salary of permanent employees or seasonal employees (whose salaries are contained in annual appropriations) to FEMA debris removal and emergency protective services projects.

9. Do not claim costs for items or activities for which you did not have a cash outlay.

10. Ensure that claims for overtime fringe benefits are based on cost items (i.e., F.I.C.A., worker's compensation, etc.) that accrue as a result of overtime. Items such as health benefits and leave are not eligible as overtime fringe benefits.

11. Ensure that expenditures claimed under the FEMA project are reasonable and necessary, are authorized under the scope of work, and directly benefit the project.

12. Ensure that you document pertinent actions for contracts awarded under FEMA projects, including the rationale for the method of procurement, the basis for contractor selection, and the basis for the contract price. Remember that Federal regulations prohibit cost-plus-percentage-of-cost contracts.

Disaster Fraud Hotline

The DHS OIG not only conducts audits, but also aggressively investigates allegations of fraud, waste, and abuse. Below are a few of the more common allegations reported through our Hotline.

- Disaster assistance applicants use false names and/or fictitious addresses.
- Disaster assistance applicants claim losses that they did not incur or were not entitled to claim.
- Private individuals claim to be FEMA employees.
- Disaster fund recipients are victimized by contractors who inflate repair fees and/or fail to properly complete repairs.
- Disaster fund recipients damage their own properties to receive disaster assistance.
- Subgrantees do not use FEMA funds for the purpose intended.

If you have knowledge of fraud, waste, or abuse, or allegations of mismanagement involving disaster relief operations, you can:

- Call the Disaster Fraud Hotline at 1-866-720-5721
- Fax the Disaster Fraud Hotline at 1-225-334-4707
- Email: disaster@leo.gov
- Or write: National Center for Disaster Fraud
  Baton Rouge, LA 70821-4909

Calls can be made anonymously and confidentially